JUN 24 1953
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

346 U.S.
WAL-V
78

No. 140

EUGENE H. WALET, JR.,
Petitioner,

versus

JEFFERSON LAKE SULPHUR COMPANY,
Respondent.

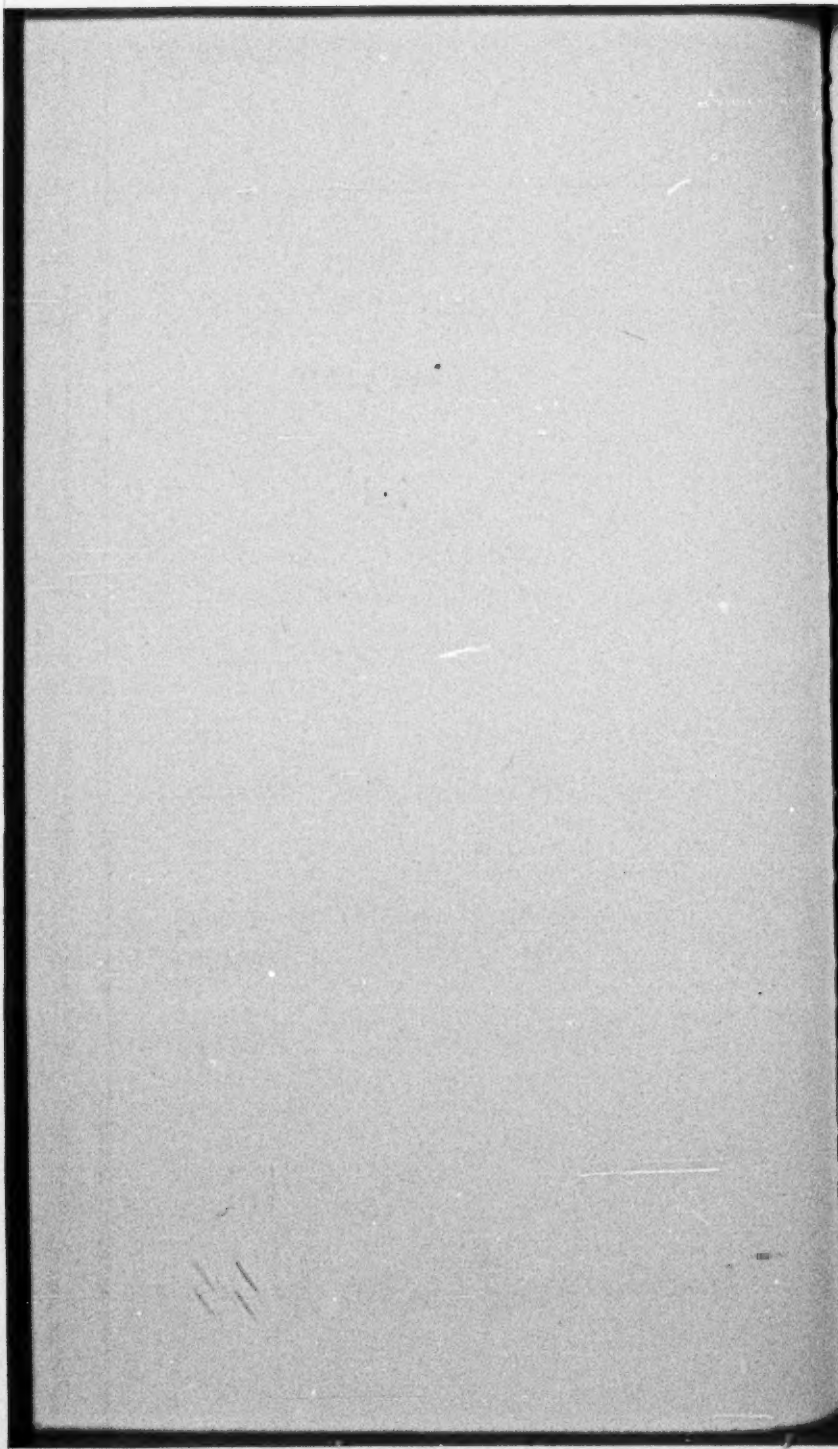
PETITION OF EUGENE H. WALET, JR., FOR WRIT OF CERTIORARI

and

BRIEF IN SUPPORT OF PETITION.

JAMES G. SCHILLIN,
Attorney for Petitioner.

HAUSER PRINTING CO., INC., NEW ORLEANS



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PETITION OF EUGENE H. WALET, JR., FOR WRIT OF CERTIORARI.

To the Honorable the Supreme Court of the United States:

Now comes Eugene H. Walet, Jr., a citizen of the United States, residing in the Parish of Orleans, State of Louisiana, and respectfully petitions this Honorable Court to grant a writ of certiorari to the Circuit Court of Appeals for the Fifth Circuit, to remove therefrom, for review here, the record in the cause therein pending, number 14,175, wherein petitioner is the appellant and respondent, Jefferson Lake Sulphur Company, is appellee, and shows:

(1)

That this Court has jurisdiction under Section 1254, Title 28 USCA.

(2)

That petitioner is now, and has been, for the past two years President and a Director of respondent corporation; that respondent filed this action against petitioner in the United States District Court for the Eastern District of Louisiana (New Orleans Division), and recovered judgment for $36,677.79 and costs, under the provisions of Section 16 (b) of the Securities Exchange Act of 1934 (15 USCA 78 p. (b); the opinion of the District Court is reported in 104 F. Supp. 20; that of the Fifth Circuit in 202 F. (2) 433; rehearing was denied on April 4, 1953.

(3)

The facts, which have been fully stipulated (R. 11-20, R. 46-49), show that at all material times petitioner was subject to the community property law of Louisiana, and his wife had an absolute, vested, proprietary interest in one-half of all the stock purchased, and profits made, in his name.

(4)

Petitioner purchased, between April 20, 1950 and May 9, 1950 2400 shares of respondent's stock for $18,-704.00; he sold 2400 shares between August 16, 1950 and November 8, 1950 for $42,573.48, thus making a profit, according to respondent's contention, of $23,869.48 which, when decreased according to petitioner's contention, by the fifty per cent thereof belonging to his wife, results in petitioner having made a profit of $11,934.74 (R. 12-14).

(5)

Petitioner sold, between November 8, 1950 and November 24, 1950, an *additional* 1200 shares of stock for

$32,008.31. This stock was represented by certificates which he owned for some time, considerably longer than six months. However, in order to show a further profit respondent has included 1200 treasury shares acquired from it under an option contract, and for which 1200 treasury shares petitioner paid directly to respondent the sum of $16,512.00. Although petitioner has not sold these 1200 option shares, *and he may ultimately sell them at a loss*, he is nevertheless charged with an additional profit of $15,496.31, which when added to $23,869.48, *supra*, makes a total asserted liability of $39,365.79. This sum was concededly reduced to $36,677.79, the amount of the judgment rendered against petitioner, for the reason that the complaint used as a base the actual cost to petitioner of the 1200 shares of option stock rather than the market value thereof at the date of the accrual of the option. (R. 37).

(6)

Petitioner shows that, under no circumstances, can his liability extend beyond 1200 shares, to-wit:

Shares involved	3600
Deduct treasury (option) shares	1200
	2400
Deduct one-half owned by wife	1200
	1200

(7)

The questions presented and the reasons relied upon for the allowance of this writ are as follows:

I.

This Court should review Section 16 (b) of the

Securities Exchange Act of 1934 from the standpoint of (a) the application which the Lower Courts have made of said Section, particularly where the facts, as here, demonstrate that not only was no damage suffered, but where it was impossible for any damage to result to any stockholder or any person whatsoever, as well as (b) to correct the inequities and injustices flowing from the arbitrary and inflexible interpretation being placed upon the statute by the Lower Courts, contrary to congressional intent.

II.

It is the well settled law of Louisiana, to be followed in the Federal Courts, that, under the community property system of Louisiana, petitioner's wife has an absolute vested proprietary interest in one-half of the stock involved in this complaint, and the profits resulting from the sale thereof, which profits the statute does not purport to reach; that to otherwise construe the statute would deprive petitioner's wife of her property without due process of law in contravention of the Fifth Amendment of the Constitution of the United States (R. 14).

III.

There is no necessity, in order to vindicate the Federal policy announced by the statute, to destitute petitioner's wife of her property, and the statute does not purport to do so. The authorities relied upon by the Courts below that, under certain circumstances State law must yield to Federal statutory policy, have not the remotest application to this case.

IV.

The Circuit Court of Appeals completely ignores the

fact that one of the contentions of petitioner *was not even an issue before the Trial Judge*, having been raised for the first time by stipulation *after the case reached the Court of Appeals*, viz., that the treasury (option) stock is exempt from the operation of Sections 16 (a) and (b) by a specific rule of the Securities Exchange Commission. Respondent agreed the Court of Appeals should pass on the contention (R. 48).

V.

The Circuit Court of Appeals perpetuates the following flagrant errors committed by the Trial Judge:

(a) That petitioner sold stock within six months after he acquired the treasury (option) stock, **although respondent has judicially admitted that this option stock is still in the possession of petitioner and his wife** (R. 15-16) (R. 27).

(b) That "treasury stock by the very fact of its purchase and issuance ceases to be such and becomes outstanding or non-treasury stock," although it is conceded that petitioner has had no transaction in such treasury (option) stock **except to acquire same.** Obviously this stock did not become "outstanding or non-treasury stock" until **after** it came into the possession of petitioner and his wife, and it is in their possession at this very moment, petitioner never having disposed of it since he acquired it under his option (R. 26, 53).

(c) In treating these treasury shares, acquired by petitioner under his option, as coming within the definition of "equity shares," although treasury shares are expressly excluded by the statute from the operation of Section 16 (b) (R. 26, 53).

VI.

The Circuit Court of Appeals has ignored every principle of equity in giving sweeping approval to the opinion of the Trial Judge, failing to even recognize the erroneous findings of fact although such findings are contrary to the unqualified admissions of respondent.

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Respondent.

BRIEF IN SUPPORT OF APPLICATION FOR WRIT OF CERTIORARI.

May It Please the Court:

FEDERAL STATUTE INVOLVED

"15 USCA 78 p. (b), Sec. 16 (b) of Securities Exchange Act of 1934.

"'(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security[1] of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer,

---

[1] Treasury (option) shares involved here are specially exempted from Sec. 16 (b) by S.E.C. Regulation, *infra*.

irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.'"

ASSIGNMENTS OF ERROR

We shall argue the points in their numerical order as stated in the petition, and assign as error the failure of the Circuit Court of Appeals to affirm the contentions of Appellant, to-wit:

I.

This Court has never, during the twenty years this statute has been in operation, given plenary review to Section 16 (b), and during that long period the inferior Federal Courts have given an arbitrary and inflexible interpretation to this Section, resulting in penalizing these officers and directors far beyond the intent of Congress when the statute was passed. In the instant case, with reference to the treasury (option) stock, every principle of equity and justice is ignored. While Sec-

tion 16 (b) makes immaterial the intention of the director, at the time he enters into the transaction, not to violate the statute, the stipulation of respondent, in the instant case, concedes that there has been no violation of the statute. Irrespective of what the legislative history of this statute indicates option privileges played in the abuses sought to be corrected by Section 16 (b), it is admitted *as a fact* in this case that every transaction was executed in the utmost good faith (R. 18), resulted from no inside information, and no damage was sustained by any person whatsoever, nor could any damage be sustained by any person with regard to this treasury (option) stock. These treasury (option) shares were not purchased from another shareholder or from a member of the general public, but were taken out of its treasury by the corporation itself and delivered to petitioner under an option agreement (R. 18).

The Courts below refused to recognize and apply such equitable principles as were enforced in *Consolidated Engineer Corp. v. Nesbit*, 102 F. Supp. 112, and *Lockheed v. Rathman*, 106 F. Supp. 810, although both cases bear striking resemblance to the case-at-bar, so far as the option stock is concerned.

II.

The statute is aimed solely at the profits inuring to the benefit of the officer or director and not to those profits belonging to his wife. The holding by the Circuit Court of Appeals that petitioner's wife must lose her profits because petitioner is the head and master of the community, and accountable for its management, is directly contrary to the established rule of property in Louisiana which holds that **the law's investiture of the**

husband with broad powers of management and control by no means negatives the wife's present interest as co-owner. (*Succession of Wiener*, 203 La. 649, 14 So. (2) 475; *Bender v. Pfaff*, 282 U.S. 127, 51 S. Ct. 64, 74 L. Ed. 252; *Fernandez v. Wiener*, 326 U.S. 340, 66 S. Ct. 178, 98 L. Ed. 116; *Poe v. Seaborn*, 282 U.S. 101, 51 S. Ct. 58, 60, 75 L. Ed. 239.) Respondent judicially admits only one-half is husband's property (R. 14).

III.

Federal intention to disrupt local property system is never implied (*Atcheson, Topeka & Santa Fe Railway v. Railroad Commissioner*, 283 U.S. 380, 392-3, 51 S. Ct. 523, 75 L. Ed. 1128). In *Wisner v. Wisner*, 338 U.S. 655, 70 S. Ct. 398, 94 L. Ed. 424, relied upon below, the Federal Government provided the fund which made the insurance proceeds possible; a liberal policy toward the insured service man and his named beneficiary was everywhere evident in the comprehensive statutory policy; the statute provided that the insured "shall have the right to designate the beneficiary, and the right at all times to change the beneficiary," and that no person should have a vested right to any of the proceeds. There is no such comparable subject-matter embodied in the instant legislation, which aims only to reach the profits realized by the person named in the statute, and not those realized by his partner or his wife.

The instant statute does not pretend to define who owns the shares or the profits therefrom. That is a matter for purely local law. There is no conflict here between the Federal policy and the State law. Each remains inviolate within its own sphere. The husband loses his property if he comes within reach of the statute; the wife retains hers because the statute does not pur-

port to touch her. The Circuit Court of Appeals in *Rattner v. Lehmann*, 193 F. (2) 564, 566, which is not even mentioned in the opinions below, did no violence to Federal policy when it maintained the integrity of the property interest of the other partners in condemning only the profits of the partner who came within the language of the statute.

IV.

The Securities and Exchange Commission on January 13, 1935 issued the following regulation (Rule X-16 A-4, Release No. 79):

> "The following securities shall be exempted securities for the purposes of Section 16 (a) and 16 (b):
>
> "Securities reacquired by or for account of the issuer and held by it or for its account.'"

The treasury (option) shares involved in this case are precisely "securities reacquired by * * * the issuer and held by it * * * ." (R. 14-18, R. 46-49).

This contention was raised in the Court of Appeals, and results from a stipulation filed in that Court. (R. 46-49). The point was not before the Trial Judge, yet the Circuit Court of Appeals gave no consideration whatever to this contention of petitioner. **We strongly urge that this omission should be corrected by this Court.**

V.

(a) The Trial Judge found (R. 26) that petitioner had sold stock within six months after he acquired the treasury (option) stock. Petitioner acquired this treasury (option) stock on November 29, 1950 (R. 14), and his last sale of *any* stock was on November 24, 1950

(R. 13). **The option stock is still in his possession. The Court of Appeals paid no attention to our complaint on this score.**

(b) Petitioner's contention in this respect cannot be successfully controverted by the holding of both Lower Courts that, after it came into petitioner's possession, it was no longer treasury stock. It was concededly treasury stock which he acquired, and it is the act of acquiring same which respondent admits is the basis of liability so far as these 1200 treasury (option) shares are concerned, not the sale of said stock *after* he acquired it. Respondent has matched 1200 shares sold by petitioner with the 1200 treasury (option) shares acquired under his option, which acquisition superseded his last sale on November 24, 1950, *supra.*

(c) We assert that "treasury shares" are not within the prohibition of Section 16 (b) because that section applies only to "equity securities," and the definition of "equity securities," Section 3 (a) (11), does not embrace "treasury shares." Under Section 3 (a) (10) the term "treasury stock" is embraced in the definition of the term "security," but Congress seems to have *ex industria*, omitted "treasury shares" from the definition of "equity shares".

VI.

It is significant that the instant suit is brought by the corporation itself, and it is noteworthy that petitioner's plea of estoppel (R. 6, *et seq.;* R. 14 *et seq.*) is leveled at the conduct of the corporation itself. Respondent has placed itself in the highly inequitable position of having impelled petitioner to enter into an option contract, stemming from respondent's desire to reward

a faithful executive officer, and having thus induced petitioner to act, respondent now seeks to profit, not from the sale by petitioner of these shares, but from the mere acquisition of them by him. We regretfully say that such conduct is, in effect, tantamount to pretending, in one breath, to compensate petitioner for admittedly extraordinary services over and beyond the call of duty (R. 15), and in the next breath, invoking a harsh and arbitrary statute which, praiseworthy as it may be when properly applied, should not be used against this petitioner, in view of special circumstances of this case and the factual issues decided in his favor by the stipulation.

The exercise of this particular option privilege cannot be said to reasonably come within the reach of the statute or the evil sought to be corrected thereby. Against the corporation itself petitioner should be permitted to exercise his option promptly, within the six-month period if he so desires, if he is to exercise it at all. Unless he could acquire the option stock, with the tax benefits intended by respondent, the option privilege did not have the value held out to petitioner, in which latter event lack of good faith should be attributed to respondent (*Shaw v. Dreyfus*, 172 F. (2) 143; *Truncle v. Blumberg*, 80 F. Supp. 387).

(8)

Petitioner avers that the decisions of the Trial Court, and the Circuit Court of Appeals are erroneous, in that said Courts have decided a most important question of local *community property law* directly in conflict with the applicable State Court decisions, and have decided an important question of Federal statutory law in a way untenable and in conflict, not alone with the

general weight of authority, but with fundamental principles of equity and justice so often recognized and maintained by this Court.

(9)

That these questions should be finally and authoritatively adjudged by this Honorable Court upon and after a full presentation to this Court of the merits of said questions on the part of petitioner and respondent.

WHEREFORE, petitioner prays that a writ of certiorari may be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding the said Court to certify and send this Court a full and complete transcript of the record and all proceedings of the said Circuit Court of Appeals in said case therein numbered, 14,175, entitled Eugene H. Walet, Jr., Appellant, vs. Jefferson Lake Sulphur Company, Appellee, to the end that said case may be reviewed and determined by this Court as provided in Section 1254, Title 28 USCA, and applicable statutes, and that your petitioner may have such other further relief or remedy in the premises as this Honorable Court may deem appropriate and in conformity with law, and that the judgment of the said Circuit Court of Appeals be reversed by this Honorable Court.

And your petitioner will ever pray.

(s) JAMES G. SCHILLIN
Attorney for Petitioner,
1113 American Bank Building,
New Orleans, Louisiana.

STATE OF LOUISIANA
PARISH OF ORLEANS
CITY OF NEW ORLEANS

PERSONALLY CAME AND APPEARED BEFORE ME, the undersigned Notary Public duly commissioned and qualified in and for the Parish of Orleans, State of Louisiana, EUGENE H. WALET, JR., who, being duly sworn, deposes and says:

That he is petitioner herein; that he is a resident of the Parish of Orleans, State of Louisiana; that he has read the foregoing petition and all the facts contained therein are true and correct; and that, as to those facts made on information and belief, deponent verily believes them to be true.

(s) EUGENE H. WALET, JR.
Petitioner.

Sworn to and subscribed
before me this 15th day
of June, 1953.

(s) MICHAEL M. IRWIN
Notary Public

FILED
JUL 27 1953
HAROLD B. WILLEY, Clerk

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Respondent.

JOINDER OF RESPONDENT IN PETITION FOR CERTIORARI

EBERHARD P. DEUTSCH,
Attorney for Respondent.

DEUTSCH, KERRIGAN & STILES,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

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Respondent.

JOINDER OF RESPONDENT IN PETITION FOR CERTIORARI

This is an action under section 16(b) of the Securities Exchange Act of 1934[1] to recover profits realized by an officer (petitioner) of plaintiff corporation (respondent) through "short swing" trading in respondent's shares.

All facts have been stipulated. Respondent concedes that all transactions of petitioner in respondent's shares were effected in the utmost good faith and without benefit of any "inside information".

---

[1] 15 USC 78p(b).

Insisting that the decision below is correct, and contesting petitioner's contentions as to the correctness of that decision, respondent nevertheless joins in the pending petition for certiorari, because the action involves questions of national importance and incipient inter-circuit conflict as to the scope of the federal statute involved, as to the interrelation of that statute and local laws in community-property states, and as to the effect of regulations of the Securities and Exchange Commission, all of which should be settled authoritatively by this court.

A

The Scope of Section 16(b)

The decision below is the third by the federal appellate courts (in the Second and Fifth Circuits) giving the broadest application and scope to section 16(b) in order to effectuate its purposes.[2]

The crucial questions decided in all three cases are (1) that actual good faith on the part of the corporate officer involved is immaterial to determination of his liability to account for "short-swing" profits; and (2) that it is immaterial whether the shares purchased and the shares sold within any six-month period were represented by the same certificates.

Recently, serious doubt has been cast, by a district court decision in California,[3] on the nation-wide authority of the appellate decisions on these important questions.

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[2] The other two are *Smolowe vs Delendo Corporation*, 136 F2d 231 (CA 2-1943), cert. den., 320 US 751, and *Gratz vs Claughton*, 187 F2d 46 (CA 2-1951), cert. den., 341 US 920.

[3] *Consolidated Engineering Corporation vs Nesbit*, 102 FS 112 (SD Calif.-1951).

On April 1, 1953, the Court of Appeals for the Ninth Circuit, reversing the district court's order refusing permission to a shareholder of the plaintiff corporation to intervene for the purpose of appealing the California decision, recognized that that decision "presents a substantial, novel and important question of law", that "this is the first instance of a court's holding that a corporation may be estopped to impose sanctions upon insiders who have traded in that corporation's securities", and that the decision is in direct confict with the one here under consideration.[4]

It is submitted that this clear, and perhaps otherwise irremediable, conflict on questions of such moment warrants attention and resolution by this court.

B

Relation of State Law to the Federal Statute

In 1930, this court decided, in *Bender vs Pfaff*,[5] that in community-property states, state law may authoritatively determine to whom income is taxable under the federal income tax law.

Since that decision, however, there has been a decided trend toward uniformity in application of the federal tax statutes regardless of the vagaries of local law.[6]

---

[4] The court further suggested that the intervener's right of appeal may have been prejudiced by his failure either to perfect the appeal within "the thirty day statutory period" or to secure an extension of that time. *Pellegrino vs Nesbit*, 203 F2d 463, 467, 469 (CA 9, 1953).

[5] 282 US 127 (1930).

[6] See, *e.g.*, *Burnet vs Harmel*, 287 US 103 (1932); *Lyeth vs Hoey*, 305 US 188 (1938); *Morgan vs Commissioner*, 309 US 78 (1940); *United States vs Pelzer*, 312 US 399 (1941).

In 1950, this court decided that the policy of a federal statute (the National Service Life Insurance Act) must prevail over local community-property laws in cases of direct conflict.[7]

In the present case, the Court of Appeals has decided that local community-property laws cannot affect the uniform operation of a federal statute (the Securities Exchange Act of 1934), even in the absence of direct conflict.

It is submitted that the importance of maintaining this constant trend away from the rule of *Bender vs Pfaff*, and toward uniformity in operation of a federal law of such widespread application, also warrants this court's express recognition and affirmance.

C

Regulations of the Securities and Exchange Commission

When petitioner's transactions in respondent's shares were effected, the following regulation of the Securities and Exchange Commission[8] was in effect:

> "The following securities shall be exempted securities for the purposes of section 16(a) and 16(b) of the (Securities Exchange) act (of 1934):
>
> * * * *

[7] *Wissner vs Wissner*, 338 US 655 (1950).

[8] The Commission has statutory authority to make such regulations under the Securities Exchange Act of 1934. 15 USC 78c(12), 78w.

"(d) Securities reacquired by or for account of the issuer and held by it or for its account." [9]

Some of petitioner's transactions involved his acquisition of treasury shares of respondent. Petitioner contends that, under the quoted regulation, his transactions in these shares should not have been included in computing the profits recoverable by respondent herein.[10]

Pursuant to representations by the Securities and Exchange Commission in its brief filed as *amicus curiae*, the Court of Appeals tacitly decided that the quoted regulation is inapplicable because the treasury shares acquired by respondent ceased to be treasury shares at the moment of his acquisition thereof.

It is submitted that while that decision is correct, the significant issue of the proper construction of the regulation, and particularly of the weight to be accorded to the Commission's interpretation of its own regulations, should also be decided by this court.

CONCLUSION.

For these reasons, respondent respectfully joins in the petition for certiorari.

EBERHARD P. DEUTSCH,
Attorney for Respondent.

DEUTSCH, KERRIGAN & STILES,
Of Counsel.

July, 1953.

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[9] 17 CFR 240.16a-4. This regulation has since been amended.
[10] Section 16(b) has no application to exempted securities.